Partnerships

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An opt-out election could cause contests in tax equity deals to be conducted at the partner rather than the partnership level. (Contests where the section 6226 procedure is chosen would remain at the partnership level.) The typical contest clause in a partnership flip tax equity transaction allows the sponsor to control any contest for losses for which the sponsor will have to indemnify the tax equity investor, but requires it to keep the tax equity investor informed. Some rethinking may be required of these contest provisions in opt-out situations. Most tax equity documents require the partners to try to push the contest back to the partnership level.

Another change is in who can be the "tax matters partner," or the partner designated to deal with the IRS on behalf of the partnership. Under current law, the tax matters partner must be a member-manager, if the partnership is a limited liability company. Starting with the 2018 tax year, the partnership can designate either a partner or a person who is not a partner with sole authority to act for the partnership in IRS audits and court proceedings.

A partnership may elect to have the new provisions apply immediately to tax years starting after it was enacted on November 2, 2015. Any partnership making such an election could not then opt out before the 2018 tax year.

California's March to 50% Renewables

by David Howarth and Mark Fulmer, with MRW & Associates, LLC in Oakland, California

California Governor Jerry Brown signed a bill — SB 350 — in early October committing the state to generate 50% of its electricity from renewable energy by 2030.

There are so many moving pieces in California with energy efficiency and rooftop solar soaking up load growth, net metering and rate design proceedings before the California Public Utilities Commission potentially changing the calculus for distributed solar, solicitations by the three main electric utilities for large amounts of energy storage, and fears from independent power producers and the California grid operator, CAISO, about how the grid will be able to adjust to more renewables.

It can be hard for outsiders to unpack the new 50% renewables target. Is it as simple as it looks: another 17% in renewable energy generation will be needed?

The short answer is no.

SB 350 adds to the moving pieces for project developers trying to identify opportunities.

In addition to increasing the state renewable portfolio standard, SB 350 contains provisions calling for the state to double energy efficiency savings in electricity and natural gas use by 2030. Since the RPS is calculated as a percentage of sales, reductions in electricity consumption will offset the potential increase in renewable energy demand from the higher targets. The bill originally set a goal to reduce petroleum usage in the state by 50%, but that provision was removed just before the assembly vote at the end of the legislative session. However, as discussed below, SB 350 still promotes transportation electrification, which would increase demand for renewable electricity.

The 50% renewable portfolio target applies to utilities, community choice aggregators and electric service providers regulated by the California Public Utilities Commission, as well as independently-governed municipal utilities and irrigation districts.

The 17 percentage point increase in the state renewable portfolio standard is phased in over time, with the existing 33% RPS in 2020 increasing to 40% in 2025, 45% in 2027, and 50% in 2030. SB 350 requires that 65% of RPS procurement be from contracts of at least 10 years or supplied from eligible resources owned by the utility or other load-serving entity. Category 1 resources, which are delivered to points on the California grid, can be banked without limit beginning in 2021. (For background about how the different types of renewable electricity are classified under the state RPS program, see "California Rules Worry Out-of-State Generators" in the May 2012 *Project Finance NewsWire* starting at page 10.)

According to the most recent RPS report from the CPUC to the California legislature, the three major California investor-owned utilities anticipate meeting nearly 31% of their retail sales with qualifying renewables by 2016. Thus, the utilities are well positioned to begin the march to meeting a 50% target over the next 15 years.

Because the utilities are ahead of schedule for meeting the existing 33% target by 2020, and there are still mandates requiring utility purchases of smaller-scale renewables that also count towards the RPS, there will probably be a pause in RPS procurement in the near term. For example, PG&E has indicated it will not hold a 2015 RPS solicitation. SDG&E last held an RPS

solicitation in 2013 and does not foresee holding another one in the next several years. However, thanks to SB 350, annual RPS solicitations should pick up again to meet the new targets within a few years.

Community Choice Aggregators

There has been a lot of interest recently in community choice aggregators. These are entities that buy power for local communities. For example, both Marin and Sonoma have community choice aggregators that were the offtakers for the 100-megawatt Mustang solar project whose financing closed in August. Many of these community choice aggregators have set their own goals to exceed 50% renewables in their communities. This growing market sector may help fill some of the slack in demand for new RPS procurement in the short term.

All of the San Francisco Bay area counties either have, or are seriously considering, forming community choice aggregators. (Serious consideration can be seen among the counties that have funded feasibility studies.) In southern California, Los Angeles County (outside of the City of Los Angeles, which is served by LADWP), San Diego County and the City of Santa Monica are also expected to form community choice aggregators.

Thus, renewable energy developers may have opportunities to respond to more, albeit smaller, renewable energy solicitations, from purchasers with little or no track-record of power purchasing or portfolio management.

In addition to SB 350, the California legislature also considered a companion bill (SB 32) during 2015 that would have set mid-term greenhouse gas targets and codified the state's 2050 goal of reducing carbon emissions to 80% below 1990 levels by 2050. Although SB 32 was ultimately withdrawn, SB 350 contains language reiterating the 2050 greenhouse gas goal, as well as setting a mid-term goal of reducing GHG emissions to 40% below 1990 levels by 2030.

SB 350 says that reaching the GHG goals will require "widespread transportation electrification" and directs the CPUC to require utilities to file applications for multi-year programs and investments to accelerate electrification of the transportation sector.

SB 350 also directs the California Public Utilities Commission to require utilities and other load-serving entities to file integrated resource plans to ensure that the entities meet the state's GHG and RPS targets while minimizing the effects on customer bills, maintaining reliability and satisfying other related goals.

Extensive modeling by the California grid operator, CAISO, and others suggests that increasing the / continued page 6

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evidence that the state legislature wanted to repeal the multistate compact provision allowing companies to elect use of the three-factor formula when it adopted a single-factor approach in 2008. The state legislature responded to the Supreme Court decision by quickly repealing the multistate compact retroactively the start of 2008.

Meanwhile, the California Supreme Court heard oral arguments in early October in a case in which Gillette and other companies are arguing they are entitled to use the multistate tax compact formula for calculating California source income.

California adopted the multistate compact in 1974. However, in 1993, its changed its law to require double weighting be given to the sales factor.

Gillette and five other companies sued the state for $34 million in refunds in 2010 arguing that they are entitled by law to use the multistate formula. A California appeals court agreed in a decision in 2012. (For earlier coverage, see the September 2012 *Project Finance NewsWire* starting on page 11.)

The state legislature voted, shortly before the appeals court released its decision, to withdraw from the multistate compact and to bar refund claims unless a company elected to use the apportionment formula in the multistate compact when it originally filed its tax return.

Similar battles are playing out in other states. Fourteen of the 20 states that belonged to the multistate compact had moved away from the three-factor formula by 2012. North Dakota replaced the three-factor formula in the compact with a single sales factor in April 2015.

NORTH CAROLINA clarified in late September how to prove solar projects are far enough along by year end to qualify for a 35% state tax credit.

A project must ordinarily be in service by December 2015 to qualify. However, the state legislature granted an extra year to complete any solar project on which the / continued page 7

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supply of renewable energy much beyond current levels will present operational challenges and probably lead to higher levels of renewable curtailment without policy changes designed to address these challenges. (For background about the risk of increasing curtailments and negative prices for renewable electricity, see "Renewables Face Daytime Curtailments in California" in the November 2014 *Project Finance NewsWire* starting at page 13.)

SB 350 directs the CPUC, where feasible and cost effective, to authorize procurement that minimizes reliance on system power and fossil fuel for maintaining grid reliability and instead to focus on large- and small-scale energy storage, targeted energy efficiency, demand response and renewable resources.

Regional Grid?

One way to integrate higher levels of renewables is to make it easier to sell excess renewable electricity from California to its neighbors and to be able to do this on a sub-hourly basis, although perhaps at zero or negative prices.

California set a new 50% renewable energy target, but the opportunity for developers is not as simple as it looks.

The CAISO has established an energy imbalance market to allow multiple balancing areas to dispatch least-cost resources automatically on a five-minute basis, thereby sharing reserves and helping to respond to changes in renewable energy generation. PacifiCorp became the first participant in November 2014. NV Energy is set to join the energy imbalance market as soon as final authorization is received from the Federal Energy Regulatory Commission and could be participating as early as December 1. Puget Sound Energy and Arizona Public Service will join in October 2016, and other utilities in the west are also considering this option.

The CAISO is in the process of establishing a new five-member governing body for the energy imbalance market with independent, regional representation to oversee and approve EIM market rules before they are presented to the CAISO board of governors for approval.

Even with the benefits provided by the EIM, the challenge of integrating up to 50% renewable energy supply will require greater levels of regional coordination.

The CAISO and PacifiCorp entered into a memorandum of understanding in April 2015 to explore the feasibility, costs and benefits of PacifiCorp joining as a participating transmission owner. A regional independent system operator would allow for day-ahead and hour-ahead scheduling of generation and transmission resources, which provides much greater opportunity to benefit from regional diversity in the integration of intermittent renewable resources.

Becoming a regional organization would represent a significant change for the CAISO, which, as its name implies, has been strictly a California grid operator since its inception. In fact, the law allowing for the establishment of the CAISO specifically prohibits the CAISO from entering into a regional organization without approval from the state Electricity Oversight Board. The CAISO governing board is appointed by the California governor and confirmed by the California Senate.

SB 350 provides a process for lifting restrictions on the CAISO entering into agreements with grid operators in other states and transitioning to a governing structure that is not subject to the parochial selection and confirmation requirements of the current CAISO board. By providing a process for the CAISO to explore becoming a regional entity and to help develop more integrated electric and transmission markets throughout the west, SB 350 addresses one of the significant challenges of extending the RPS to higher and higher levels of renewable penetration.

The process involves the CAISO developing a revised governance structure and studying the impacts of a regional market

on ratepayers, the California economy, the environment, disadvantaged communities, GHG emissions, reliability and integration of renewable energy resources. The governor must then submit the revised governance and studies to the legislature by December 31, 2017. The revised governance structure would not become effective until after the legislature enacts a statute implementing the changes. There are many moving pieces, but they have a way eventually of falling into place.

Community Solar Gains Ground in New York

by Todd Alexander and Christopher Vale, in New York, and John Marciano III, in Washington

New community solar rules that took effect in New York in late October should help jump start community solar development in that state. The rules make it possible to build projects at utility-scale costs and sell electricity directly to customers at higher rates than utilities pay for utility-scale power.

New Playbook

The new rules provide incentives for projects with capacities of up to two megawatts and require participation by at least 10 customers in each project. Projects larger than two megawatts can be still be built, but only the first two megawatts are eligible for credits and incentives. Projects must serve customers located within the same utility service area and NY independent system operator load zone as the facility.

Projects generate net-metering credits based on the amount of net electricity generated. Customers whose electricity consumption is 25 kilowatts or more cannot as a group receive more than 40% of the net-metering credits generated by the project. An electrical load of 25 KW is usually the breakpoint between commercial and industrial customers versus residential customers. Thus, residential customers need to receive at least 60% of the net-metering credits generated by the project. The percentages refer to the facility's aggregate output allocated to each type of customer. Thus, an array that has one commercial customer receiving 40% of output and hundreds of residential customers receiving 60% of output would qualify.

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developer has "incurred" at least a minimum percentage of project costs and completed a minimum percentage of "physical work" by December. The percentage is 50% for projects with a DC capacity of 65 megawatts or more. It is 80% for smaller projects.

Developers had to notify the state tax department by October 1, 2015 of any potentially eligible 2016 projects by letting the department know each location, total cost estimate and project size.

Proof of the incurred costs and percentage completion must be submitted by March 1, 2016. The developer must certify in writing as to the costs and physical work completed, and it must submit notarized reports from a certified public accountant attesting to the costs and from an independent engineer about the percentage of physical work completed. Both the engineer and accountant must be licensed in North Carolina. The state may release forms in January to use for making these certifications.

The state released a series of frequently-asked questions and answers in late September.

Costs are not considered "incurred" for *federal* income tax purposes until delivery of equipment or services; it is not enough for the developer merely to have paid money.

The latest state guidance is ambiguous about what is required in North Carolina. However, an official with the state tax department confirmed by email that "economic performance" is not required and that accrual of costs is enough. Costs are considered accrued when the developer is legally obligated to pay and the amount is known. There is no deadline actually to have made the payment, although a long delay may call into question whether there was really a legal obligation to pay.

The state issued a table to guide engineers on how to measure the percentage of completion. According to the table, a solar project is considered 5% complete at the end of design, engineering and site preparation, another 20% complete after all the posts have been installed, another 15% complete when / *continued page 9*

Environmental Update

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made offers to cut emissions with or without assistance from developed countries and pledged additional cuts if financial and technological assistance is provided. The remaining one quarter of the pledged emissions cuts turn on whether developing nations receive funding from developed nations.

The negotiations in Paris will focus on reaching a global agreement to reduce projected emissions increases by 2030, but not produce actual aggregate reductions from current levels. The pledges would reduce global average per-capita emissions over the next 15 years by as much as 9% in 2030.

Banks

A new report examining 61 of the world's largest banks on their management of climate-related risks concludes that few are taking a strategic approach. Investment manager Boston Common Asset Management reports that the world's largest banks are not prepared for the effects of climate change and argues that lenders are making an insufficient effort to support the transition to a low-carbon economy that is being discussed at COP-21 in Paris.

Banks have a critical role to play in funding the transition. The report concludes that most lenders do not have quantitative targets for increased financing of energy efficiency or renewable energy projects. The key criticism is that many banks fail adequately to assess the carbon risk of their lending and underwriting or to conduct climate-related stress tests.

Of the world's 10 largest banks, only Citigroup and Bank of China were among the top 10 ranked for climate management.

— contributed by Andrew Skroback and Richard Waddington in Washington

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